

## **Pension and Health Care Costs for Public Retirees Crisis or Challenge?**

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Employee benefits are certainly a hot topic – whether in government circles, employee groups or general business planning sessions. Recent disclosure requirements adopted by the Government Accounting Standards Board (GASB) are shining a spotlight on the obligations state and local governments have to their retired employees. These obligations come in the form of pension benefits as well as what are called “Other Post-Employment Benefits,” or OPEB. The largest category of OPEB is health care.

Many jurisdictions in California as well as around the country do not have budgeted funds sufficient to meet their long-term retiree obligations. What that means is that there is a difference between the amount of money in retirement fund investment pools and the amount of money that would be needed to meet the pension obligations these jurisdictions have to their retirees. On the OPEB side, it means that there is a gap between the amount of money set aside for such things as retiree health care cost obligations and the amount of money required for these obligations to be fully funded.

These differences are called “unfunded liabilities” and the term is often used negatively when addressing the issue of public employee benefits. Editorials speak forebodingly of the “ticking financial time bomb,” the “fiscal horror show” and the “pending fiscal train wreck” of “unfunded liabilities” and “runaway pension costs.” However, let’s look more closely at what this actually means.

Indeed, some of the reported unfunded liability estimates in California appear to be staggering, although all should be read with caution. There are only a few definitive reports on this subject and most use out-of-date information. Some even combine pension and health care obligations while others do not. The new GASB disclosure requirements for most jurisdictions do not take effect until June, so authoritative numbers are months away. Some of the unfunded liability estimates reported in the press include: CalPERS at \$29 billion; the Los Angeles Unified School District at more than \$10 billion; Los Angeles County at \$9 billion; Orange County at \$2.3 billion; the City of Los Angeles at \$2.1 billion and the City of San Diego at \$1.4 billion. In January, the State Teachers Retirement System (STRS) formally announced its unfunded liability at \$20.3 billion. A recent and widely disputed report by the Center for Government Analysis put the statewide liability on the pension side at \$50.9 billion. It did not estimate the health care side.

None of these numbers mean anything without some measurement of a retirement system's assets that are available to pay benefits. So "unfunded liability" is often expressed in terms of percentages and, expressed that way, the numbers for many jurisdictions do not appear so dire. With over \$225 billion in assets, for example, CalPERS is more than 90% funded on the pension side and generally speaking, any retirement system with that level of funded liability is considered to be in very good shape. The City of Long Beach, by the way, which is a PERS member agency, is at 98.2% funded for miscellaneous employees and at 103% funded for safety employees.

The political reaction to some of the larger unsupported liability numbers has varied. Efforts at the state level to "rein in" pension costs have included unsuccessful legislation originally supported by the Governor to move the state to a "directed contribution" system similar to a 401(k) plan and away from the "defined benefit" system currently in place. The Howard Jarvis Taxpayers' Association is developing a statewide initiative that reportedly would move public retirement plans to a directed contribution system. The County of Santa Clara last year changed from five to ten the number of years an employee must work before becoming eligible for retirement benefits. On the OPEB side, the County of San Diego last year eliminated the health care benefit for employees who retired after March 2002, affecting 2,600 recent retirees and all current employees. Over the opposition of public employee unions, voters in the City of San Diego last November approved a charter provision requiring voter approval for any change in the city's pension plan, including any changes in benefits. An effort reportedly is underway to put a similar measure before voters in Orange County.

For their part, public employee and retiree organization representatives view these actions as unwarranted attacks on well-earned benefits. The unfunded liability "crisis" is a "media creation," one labor leader told a Public Retirement Journal workshop in January. Most systems, he said, should be "fully funded within the next couple of years."

Two recent developments will have a bearing on the debate and discussion going forward. The first is the creation by the Governor of the Public Employee Post-Benefits Commission. And the other is the establishment by CalPERS of a Health Care Pre-Funding Program.

The Governor's Commission was created to propose ways to address growing pension and retiree health care obligations of California's state and local governments. Specifically, the Commission is tasked to:

- Identify the total unfunded pension and health care liabilities of state and local government in California;

- Evaluate and compare various approaches to address the unfunded obligations; and
- Propose a plan to address those obligations by January 1, 2008.

Consisting of twelve members from employee unions, investment banks, the academic community and public agency management, the Commission held its first meeting in March 2007 and legislators, public agency employers and employees alike are closely following its deliberations.

CalPERS' Health Care Pre-Funding Program is based on the CalPERS investment pool model under which most CalPERS pension benefits are paid by interest earnings on investments. Under the Program, agencies that participate in the CalPERS health plan may contribute to the Pre-Funding Program with the objective of reducing their health cost obligations by virtue of interest earnings on investments under this Program. Last year Governor Schwarzenegger vetoed legislation that would enable CalPERS to offer the program to any local public entity, whether or not that entity is a CalPERS member or participates in the CalPERS health plan. However, the legislation is likely to be introduced again this year in a form that meets the Governor's objections.

It is important that retirees and public employees interested in their retirement futures remain informed of the evolving discussion and debate concerning public pension and OPEB developments. As that discussion proceeds, I would hope that the public and public policy-makers keep in mind some key facts:

- GASB standards do not require that pension and OPEB obligations be fully funded at all times. They simply require that the obligations be disclosed in a transparent way.
- The GASB standards do not jeopardize the pension or OPEB benefits of any existing retiree. Those benefits are vested and legally protected.
- For better or worse, whether or not a given pension system is fully funded is more a function of investment performance than anything else. In 2000, most systems were in very good shape. With the precipitous and prolonged decline in the stock market by virtue of the "dot.com" bust in 2001, combined with the devastating market impact of 9/11, unfunded liabilities grew. A robust and sustained growth in the stock market will reduce those liabilities, just as a protracted slump could make them increase.
- Jurisdictions with large unfunded liabilities relative to assets need to develop plans to address the imbalance. The magnitude of that imbalance, without a plan to deal with it, contributes to the panic and anti-public employee and retiree drumbeat some interests are all too willing to exploit.

It is also important that the discussion remains fact-based and the discourse remains civil. Public employees and retirees should not be scapegoated as public decision-makers address the challenge of keeping their side of the bargain with retirees. Pension and other post-employment benefits, after all, are part of the compensation package of public servants dedicated to their professions in public service. Additionally, governments should not be vilified for reviewing options to keep costs in line with budgets and income as they try to provide an economic balance for all residents in the jurisdiction.

No doubt, all of us entrusted with the fiscal propriety of our local jurisdictions will watch the evolving discussion and legislation with great interest. As government and the number of individuals devoted to public service continue to grow, this issue will be in the spotlight.

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